Featured Article

# Strategic Insights for Companies Facing Trade Secret Disputes: A Defendant's Perspective

From the perspective of defendant, this article discusses the general situation of the trade secret dispute, the possible legal liability, and the coping strategy. By analyzing the trial of China's trade secret cases in recent years, the article summarizes the characteristics of the court's trial of such cases and the principle of adjudication, and points out that the legal liability of the defendant in the trade secret dispute is increasing, so we need to pay more attention to the effective defense strategy and reasons. The article further elaborated the common defense reasons and points to pay attention in the trade secret disputes, and from many angles for enterprises in the face of trade secret infringement disputes to provide practical countermeasures and suggestions.

## I. Overview of Trade Secret Disputes from the Perspective of the Defendant and Its Possible Legal Liability

With the rapid development of China's market economy, trade secret dispute cases show an increasing trend year by year. In recent years, the number of trade secret cases heard by Chinese courts has increased significantly, and the amount involved is getting larger and larger, which has a profound impact on the operation of enterprises. When trying such cases, the courts gradually pay attention to protecting the legitimate rights and interests of the trade secret right holders, and at the same time strictly examine the defense reasons of the defendants. As a result, defendants

face increasing legal liability in such cases and need to pay more attention to defense reasons and coping strategies.

On April 17, 2024, Shanghai No. 3 Intermediate People's Court and Shanghai Intellectual Property Court held a press conference on the trial of trade secret cases, reporting the information of their trial of civil, administrative and criminal cases of trade secrets, among which: From 2015 to 2023, the court accepted 13 criminal cases of trade secrets, including 9 cases of first instance and 4 cases of second instance, and 265 civil cases of trade secrets, including 179 cases of first instance, 57 cases of second instance and 29 other cases; One administrative case of trade secrets was accepted. Judging from the cases accepted over the years, although the proportion of trade secret cases in intellectual property cases is not high, the overall trend is still stable and rising. The characteristics of the trade secret cases tried by the court are summarized as follows: 1. Most of the parties are operators and practitioners in the high-tech field; 2. From the perspective of the causes of the cases, most of the disputes were caused by the flow of talents; 3. From the perspective of the amount involved, the subject of litigation or the amount of crime is high; From the perspective of infringement, the use of network technology has gradually become the main means; 5. Judging from the results, it demonstrates the strength of judicial protection and crackdown.

The trial conditions and characteristics of the above trade secret cases are basically consistent with those of other courts in our country. In trade secret disputes, the legal representative of the defendant and the person directly responsible for the infringement risk of trade secret and the risk of criminal crime increase. Under the background of strengthening trade secret protection, the defendant has a higher burden of proof than before. If the defendant's act is found to be an infringement, he not only needs to bear civil liability, but also may face administrative liability or even criminal liability. Therefore, when facing a trade secret dispute, the defendant must fully understand the legal risks he may face and actively prepare effective defense reasons and coping strategies.

## II. Key Defenses and Precautions for Defendants in Trade Secrets Disputes

### (1) Objections to jurisdiction

In a trade secret infringement lawsuit, the defendant may file a jurisdictional objection during the defense period, questioning whether the accepting court has jurisdiction over the case. Usually, the court in the place of the trade secret infringement (including the place where the infringement was committed and the result of the infringement occurred) and the defendant's domicile have jurisdiction over such cases, but in practice, there are

disputes over the sale of the product accused of infringing the trade secret and whether the seller can serve as the jurisdictional connection point. Because "selling" is not an act of trade secret infringement regulated by China's Anti-Unfair Competition Law, if the plaintiff determines the jurisdiction court of the case based on the place of sale of the infringing product or only the seller as the defendant, then the defendant can file a jurisdictional objection.

The Supreme People's Court held in the jurisdiction objection case of disputes over trade secret infringement of Siwei Industrial (Shenzhen) Co., Ltd. v. Avery Dennison Co., Ltd. and other that: [1] According to the provisions of the Anti-unfair Competition Law, the sale of infringing products made by infringing trade secrets does not belong to the acts of infringement of trade secrets listed in the Law, so the act accused of selling infringing products made by infringing trade secrets is not the act of infringement of trade secrets stipulated in the Anti-unfair Competition Law. The process of using trade secrets is usually the process of manufacturing the infringing product. When the manufacturing of the infringing product is completed, the infringing result of using the trade secret will occur at the same time, and the place of sale of the infringing product should not be regarded as the place of infringement result of using the trade secret.

The book *Understanding and Application of the Provisions of the Supreme People's Court on the Cause of New Civil Cases* prepared by the Research Office of the Supreme People's Court also has a similar point of view: The protection of trade secrets is different from patent protection. The protection of trade secrets, especially technical secrets, is about the information used in the manufacturing process of a product, and does not extend to the protection of the product itself. Therefore, the seller of the product cannot simply be the defendant in a lawsuit, nor can the court of the place where the product is sold exercise jurisdiction over the manufacturer of the product, unless the prima facie evidence has shown that the seller and the manufacturer constitute a joint infringement.[2]

Therefore, under such circumstances, the defendant may file a jurisdictional objection and ask the court to transfer the case to the right court, so as to eliminate the interference that may exist in the original trial court.

### (2) The defense of ownership of rights

The right ownership defense mainly refers to the fact that the trade secret involved does not belong to the plaintiff, or the

1 Case No.: (2007) Min San Zhi No. 10.

2 See: *Understanding and Application of the Provisions of the Supreme People's Court on the Cause of New Civil Cases*, Research Office of the Supreme People's Court, People's Court Press, Nov. 2021.

plaintiff is not an interested party or licensee of the trade secret. In a trade secret infringement case, the subjects that can be sued according to law include: the right holder or the interested person of the trade secret. A licensee of exclusive use of a trade secret may separately file a lawsuit for infringement of a trade secret; A licensee of sole use of a trade secret may file a lawsuit for infringement of the trade secret jointly with the right holder, or file a lawsuit on its own if the right holder does not file a lawsuit; A licensee of general use of a trade secret may jointly file a lawsuit for infringement of a trade secret with the right holder, or file a lawsuit separately with the written authorization of the right holder.

In the defense of ownership of the right, two different situations of internal legal relationship and external legal relationship should be distinguished. The internal legal relationship mainly involves the ownership of trade secret rights between the enterprise and the employee, including the identification of service invention-creation and non-service invention-creation, and whether there is an agreement on the ownership of rights between the enterprise and the employee. The internal legal relationship also includes the agreement on the ownership of trade secrets between the plaintiff's affiliated enterprises. External legal relationship mainly refers to whether there is a commissioned or cooperative development relationship between the plaintiff and other subjects, and how the parties agree on the ownership of rights. If there is no agreement, it is necessary to reasonably determine the ownership of the trade secret according to the provisions of the "technology contract" part of China's Civil Code. If the plaintiff is not the right holder or interested party, its subject qualification in the trade secret litigation does not meet, the defendant should promptly put forward such defense reasons.

**(3) Burden of proof**

In a trade secret dispute, the burden of proof is the key point. The defendant may contend that the plaintiff has not adequately demonstrated the existence of its trade secret or the defendant's infringement, including whether the information disclosed or utilized by the defendant differs significantly from or lacks substantial similarity to the trade secret information claimed by the plaintiff.

The Anti-Unfair Competition Law amended in 2019 added Article 32, which is widely considered to reduce the burden of proof on the right holder and increase the burden of proof on the accused infringer. Article 32 comprises two clauses, with the first clause stipulating the transfer of the burden of proof for trade secret elements and the second clause stipulating the transfer of the burden of proof for trade secret infringement. In practice, the defendant should carefully consider the legal elements in this clause and actively present evidence to demonstrate that the plaintiff has not met the threshold for

shifting the burden of proof. For example, the defendant may prove the possibility that he did not have access to the plaintiff's trade secrets; The products referred to in the trade secrets involved are general-purpose products with relatively simple technology and easy development; The defendant completed research and development by himself and has a complete research and development record; There is no risk of further disclosure of the trade secrets involved.

**(4) Reverse engineering**

Article 14 of *Judicial Interpretation on the Application of Law in Civil Cases Involving Trade Secrets Infringement by the Supreme People's Court* (hereinafter referred to as the "Judicial Interpretation of Trade Secrets") [3] stipulates: "Where the accused infringing information is obtained through self-development or reverse engineering, the people's court shall determine that it does not belong to the infringement of trade secrets as provided for in Article 9 of the Anti-Unfair Competition Law. The term "reverse engineering" as mentioned in the preceding clause refers to utilize technical methods to disassemble, measure, and analyze products acquired from public channels, one can acquire pertinent technical information about the product. Where the accused infringer, after obtaining the trade secret of the right holder by improper means, claims that the trade secret has not been infringed on the grounds of reverse engineering, the people's court shall not support it."

As we all know, the right holder of a trade secret does not have exclusive rights and cannot prohibit other business operators from using the same or substantially the same technical solutions that they have legally developed. If the defendant does not have the possibility of accessing the plaintiff's trade secret, of course, the technical solution developed by himself may be freely used and does not constitute infringement. In the dispute between Xi 'an Aerospace Huawei Chemical & Biological Engineering Company and Yangzhou Yongfeng Company over infringement of technical secrets, the Supreme People's Court found that the unauthorized measurement of Huawei Company's equipment by Yongfeng Company at Yufeng Company, as claimed by Huawei Company, belongs to the category of reverse engineering, and is not theft as claimed by Huawei Company. Moreover, when Yongfeng Company measured Huawei Company's equipment at Yufeng Company's place, Huawei Company also failed to prove that it had taken confidential measures to prevent Yongfeng Company from measuring. Therefore, Huawei Company claim that Yongfeng Company stole and disclosed its technical secrets cannot be established.[4]

It should be noted that the defendant's reverse engineering behavior should be

3 See：Fa Shi〔2020〕 No. 7.

4 Case No.: (2020) Zui Gao Fa Zhi Min Zhong No. 9.

carried out before contacting the trade secret information of the right holder. If the defendant conducts reverse engineering after obtaining the trade secret of the right holder by improper means, the possibility of the defense being supported by the court will be lost.

**(5) The defense of personal trust**

The personal trust defense mainly occurs in disputes over infringement of business secrets (customer information). Article 2 of the Judicial Interpretation of trade secrets stipulates: "Customers engage in transactions with an employee's employer based on trust in the individual employee. If the employee departs and can demonstrate that the customer willingly chose to transact with either the employee or their new employer, the court shall consider that the employee did not acquire the trade secret of the rights holder through improper means." In practice, if the defendant claims that the customer entered into a transaction with the employee mainly based on his personal trust, he can provide the following evidence:

(1) A description of the characteristics of the industry in question that emphasizes the individual's skills;

(2) Statements, descriptions, chat records and emails from customers that clearly indicate that they voluntarily choose transactions based on their trust in employees;

(3) The transaction with the relevant customer does not take advantage of the material conditions, trading platform documents and communication records provided by the plaintiff;

And (4) Other evidence that can prove that the alleged infringement information is based on personal trust.

It should be noted that the adoption of the personal trust defense does not only require the customer to issue a written statement of voluntary transaction. The statement of voluntary transaction issued by the customer only shows that the customer voluntarily chooses to deal with the defendant, and cannot prove that the customer's previous transaction with the plaintiff was based on the employee's personal trust. Therefore, the defendant adopts the personal trust defense, and the evidence should be more focused on the decisive factor of the customer's previous transaction with the plaintiff is the employee's individual rather than the material conditions, reputation or product quality provided by the plaintiff and other factors. In the case of Shanghai Haoshen Chemical Reagents Co., Ltd., Shanghai Meishu Chemical Products Co., Ltd. v. Zhu Jiajia and Shanghai LiJing Trading Co., Ltd. for infringement of trade secrets [5], the Shanghai Yangpu District People's Court

5 Case No. : (2019) Hu 0110 Min Chu No. 1662, this case was selected as a typical case of strengthening intellectual property protection of Shanghai court in 2019.

held that: For the defense of personal trust, as the customers in question were obtained by Zhu Jiajia at the plaintiff's company after the two plaintiffs provided the necessary assistance and other conditions, rather than based on Zhu Jiajia's personal input and effort, and Zhu Jiajia could not prove that these customers had initiated transactions with the defendants. Therefore, the court rejected the defendant's defense of personal trust.

**(6) The technological contribution rate in the calculation of damages**

In trade secret infringement disputes, the calculation of damages is a complicated problem. The defendant can argue that the technological contribution rate, the extent to which the trade secret involved contributed to the plaintiff's product or service, should be taken into account when calculating damages. This helps to reasonably determine the amount of damages. The Supreme People's Court held in the dispute between Guangzhou Tianci Company, etc., v. Anhui Neumann Company, etc., over the infringement of technical secrets: [6]The infringement profit of the infringer should have a causal relationship with the infringement, and the profit generated by other rights and production factors should be reasonably deducted, that is, when calculating the amount of compensation for infringement damage, the technical secret involved should take into account the technical proportion in the production of the accused infringing product and its contribution to the sales profit. Based on the established facts, the Newman Company utilized products from the Carbomer series, and their production processes, equipment, and certain components infringed upon Tianci's technology; however, their Carbomer formula was not found to have violated Tianci's technology. When determining the profit from the infringement, the court of first instance did not consider the role of the technical secret involved in the overall process of Carbomer, and did not fully consider the role of other production factors other than the technical secret information involved in the production process of Carbomer products, which is improper, and the court hereby corrects it according to law. Taking into account the role of the infringed technical secret in the production process of Carbomer products, the court determined that the contribution degree of the technical secret involved was 50%.

As can be seen from the above, in trade secret infringement cases, the defendant should consider the technical contribution rate in the calculation of damage compensation, and reasonably determine the amount of damage compensation by calculating the technical contribution rate, so as to avoid bearing high liability for compensation. It is important to note that the term "technological contribution rate" in this context specifically refers to the

6 Case No.: (2019) Zui Gao Fa Zhi Min Zhong No. 562.

trade secret's contribution to the plaintiff's or defendant's product profits. Non-technological factors such as capital, management, and labor should be excluded from the calculation of product profits, as well as non-related trade secrets like patent technologies. In essence, the technological contribution rate of a specific trade secret equals the proportion of that trade secret within technical factors multiply by the proportion of technical factors within all production factors.

## III. Recommendations for Resolving Trade Secret Disputes From the Perspective of Defendant

As mentioned before, with China's emphasis on the protection of intellectual property rights, the protection of trade secrets is gradually enhanced, and the defendant bears more and more burden of proof and legal liability. The defendant shall take measures to prevent the trade secret dispute from adversely affecting the operation of the enterprise. After a trade secret dispute occurs, the defendant shall take timely, reasonable and effective coping strategies to minimize losses. To be specific, the following measures can be taken:

(1) Internal verification: When facing a trade secret dispute, the enterprise should first conduct a comprehensive internal verification to understand the specific situation of the trade secret involved, including its formation process and confidentiality measures. This will help enterprises better understand the case and develop effective defense strategies.

(2) Active response: Once faced with trade secret disputes, enterprises should actively respond, collect and sort out relevant evidence in a timely manner, and determine appropriate defense strategies and reasons.

(3) Procedural defense: In the course of litigation, the defendant can defend from procedural aspects, such as objections to jurisdiction. This helps to fight for a more favorable litigation environment.

(4) Evidentiary defense: The defendant can defend from the perspective of evidence, such as questioning the legality, authenticity and relevance of the plaintiff's evidence. At the same time, the defendant should also actively collect and submit evidence in favor of his own.

(5) Substantive defense: In the substantive aspect, the defendant can defend from the aspects of ownership of rights, burden of proof, calculation of compensation, etc. For example, argue that the plaintiff is not the right holder of the trade secret involved or the plaintiff fails to fully prove the existence of its trade secret.

(6) Dispute resolution: In a trade secret dispute, the defendant may also consider resolving the dispute by means of

settlement or mediation. This helps reduce the cost and risk of litigation.

## IV. Conclusion

Trade secret dispute is one of the common legal problems in the process of enterprise operation. From the perspective of defendant, this article discusses the general situation of the trade secret dispute, the possible legal liability, the common defense reasons and points for attention. At the same time, it provides practical countermeasures and suggestions for enterprises in the face of trade secret infringement disputes. These suggestions help enterprises to better understand the case, formulate effective defense strategies and reduce legal risks. In the future development, enterprises should pay more attention to the risk prevention and control of trade secrets to prevent and deal with potential disputes.

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